

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF SOUTH CAROLINA

IN RE:

Southern Textile Knitters, Inc.,

Debtor.

Robert F. Anderson,

Plaintiff,

v.

Samuel H. Simchon, Levy Simchon, Rebecca  
Simchon, Oded Simchon, Renee Simchon,  
Southern Textile Knitters of Greenwood, Inc.,  
STK de Honduras Sewing, Inc., Excel Dyeing  
and Finishing, Inc., Center Pointe  
Construction, Inc., Old Fort Industrial Park,  
L.L.C., Hava Simchon and Bay Island  
Sportswear, Inc.

Defendants.

C/A No.98-07203-W

Adv. Pro. No. 99-80026-W

JUDGMENT

Chapter 7

FILED

2000 JUL 27 AM 8:26

U.S. DISTRICT COURT  
DISTRICT OF SOUTH CAROLINA

ENTERED

JUL 28 2000

V. L. D.

Based upon the Findings of Fact and Conclusions of Law as stated in the attached Order of the Court, judgment is granted in favor of Defendants on the following remaining causes of action: (a) First Cause of Action- Turnover as it relates to Southern Textile Knitters of Greenwood, Inc. ("STKG"); (b) Second Cause of action- preferential transfers pursuant to §547; (c) Third Cause of Action- fraudulent transfers pursuant to §548; (d) Fifth Cause of Action- breach of fiduciary duty as it relates to Samuel Simchon ("Simchon"); (e) Sixth Cause of Action- piercing the corporate veil as it relates to Simchon; (f) Seventh Cause of Action- aiding and abetting; (g) Eighth Cause of action- conversion as it relates to the transfer of operating funds to STK de Honduras Sewing, Inc. ("STKH") and of inventory to both STKH and Simchon; and (h) Ninth Cause of Action- fraudulent transfers pursuant to South Carolina Code §27-23-10. As to the First Cause of Action (Turnover) as it relates to STKH and Simchon, the Eighth Cause of

Action (Conversion) as it relates to the equipment transferred to STKH, and the Thirteenth Cause of Action (Rent Due); the Court finds in favor of Robert F. Anderson. Therefore, the Court orders STKH and Simchon to turn over the equipment presently in Honduras to the Trustee within 30 days of the Order. The Court further orders that STKH and Simchon pay to the estate the sum of \$114,000.00, the rent due under the lease of Debtor's equipment from May 1, 1997 to present, and continuing until the equipment is turned over.

  
UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina

July 26, 2000.

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF SOUTH CAROLINA

IN RE:

Southern Textile Knitters, Inc.,

Debtor.

Robert F. Anderson,

Plaintiff,

v.

Samuel H. Simchon, Levy Simchon, Rebecca  
Simchon, Oded Simchon, Renee Simchon,  
Southern Textile Knitters of Greenwood, Inc.,  
STK de Honduras Sewing, Inc., Excel Dyeing  
and Finishing, Inc., Center Pointe  
Construction, Inc., Old Fort Industrial Park,  
L.L.C., Hava Simchon and Bay Island  
Sportswear, Inc.

Defendants.

C/A No.98-07203-W

Adv. Pro. No. 99-80026-W

**ORDER**

Chapter 7

**FILED**  
2000 JUL 27 AM 8:27  
DISTRICT OF SOUTH CAROLINA

**ENTERED**  
JUL 28 2000  
V. L. D.

THIS MATTER comes before the Court for Trial on the Complaint of the Trustee, Robert F. Anderson. On January 26, 1999, the Trustee commenced this adversary proceeding against certain of the defendants with the filing of an initial Complaint. The initial Complaint was then twice amended, once on February 1, 1999 and then again on July 6, 1999. The Second Amended Complaint asserted the following causes of action against Samuel H. Simchon, Levy Simchon, Rebecca Simchon, Oded Simchon, Renee Simchon, Hava Simchon, Southern Textile Knitters of Greenwood, Inc., STK de Honduras Sewing, Inc., Excel Sewing and Finishing, Inc., Center Pointe Construction, Inc., Old Fort Industrial Park, L.L.C., and Bay Island Sportswear, Inc.: (1) turnover of assets pursuant to 11 U.S.C. §542<sup>1</sup>; (2) preferential transfers pursuant to

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<sup>1</sup> Further references to the Bankruptcy Code shall be by section number only.

§547; (3) fraudulent transfers pursuant to §548; (4) post-petition transfers pursuant to §549; (5) breach of fiduciary duty; (6) piercing the corporate veil; (7) aiding and abetting; (8) conversion; (9) fraudulent transfers pursuant to South Carolina Code §27-23-10; (10) civil conspiracy; (11) subordination of claims; (12) accounting of assets; (13) rent due by STK de Honduras; and (14) money owed by Hava Simchon. The Trustee and defendants filed cross-motions for Summary Judgment as to many of these causes of action, and the Court granted Summary Judgment in favor of defendants on some causes of action, leaving the remaining causes of action for trial on the merits. By Order entered November 5, 1999, the Court dismissed the eleventh cause of action against Bay Island Sportswear, Inc., thus resolving the matter as it related to that defendant. As to Excel Finishing Inc., by Order entered on November 24, 1999 and pursuant to the parties' agreement on the matter, the Court granted Excel Finishing Inc.'s Motion for Summary Judgment. The Trustee's claims against Hava Simchon were tried separately, and by Order entered March 13, 2000, the Court granted judgment in favor of Hava Simchon on all remaining causes of action against her. By Orders entered March 13, 2000 and April 3, 2000, the Court also granted judgment on partial findings pursuant to Fed. R. Civ. P. 52(c), made applicable in bankruptcy proceedings pursuant to Fed. R. Bankr. P. 7052, on all causes of action against Levy Simchon, Rebecca Simchon, Oded Simchon, Renee Simchon, Center Pointe Construction, Inc., and Old Fort Industrial Park, LLC. Finally, by Order entered July 19, 2000, the Court also found that, because Southern Textile Knitters, Inc. ("Debtor") was solvent at least through July 31, 1998, all causes of action against the remaining defendants, which require, as a necessary element, insolvency of Debtor on or before July 31, 1998, should be dismissed.

The remaining defendants are Samuel H. Simchon ("Simchon"), Southern Textile Knitters of Greenwood, Inc. ("STKG"), and Southern Textile Knitters de Honduras ("STKH")

(collectively “Defendants”). The remaining causes of action against Defendants are as follows: (a) turnover of assets pursuant to §542; (b) preferential transfers pursuant to §547(b) as it relates to the transfer of inventory and Debtor’s business to Simchon and STKG; (c) fraudulent transfers pursuant to §548(a)(1)(B) as it relates to the transfer of inventory and Debtor’s overall business to Defendants; (d) fraudulent transfer pursuant to §548(a)(1)(A) as it relates to the transfer of inventory and Debtor’s overall business to STKG, the transfer of salary payments and the Excel Dyeing and Finishing, Inc.’s stock and inventory to Simchon, and the transfer of operating funds and inventory to STKH; (e) breach of fiduciary duty as it relates to Simchon; (f) piercing of the corporate veil as it relates to Simchon; (g) aiding and abetting; (h) conversion as it relates to STKH and Simchon; (i) fraudulent transfers pursuant to S.C. Code Ann. §27-23-10 as it relates to the transfer of inventory and Debtor’s overall business to Defendants, the transfer of operating funds to STKH, and the transfer of salary and interest in Excel Dyeing and Finishing, Inc.’s stock to Simchon; and (j) rent due by STKH.

After reviewing the pleadings in this matter, considering the evidence presented at trial, and hearing the arguments of counsel, the Court makes the following Findings of Fact and Conclusions of Law pursuant to Fed. R. Civ. P. 52, made applicable by Fed. R. Bankr. P. 7052.<sup>2</sup>

### **FINDINGS OF FACT**

1. On October 20, 1988, Debtor was incorporated as a subchapter S corporation for the purpose of manufacturing textile and apparel goods. The original capitalization of Debtor was \$10,000, distributed as follows: Simchon contributed \$3,500 and obtained 35% of the original

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<sup>2</sup> The Court notes that to the extent any of the following Findings of Fact constitute Conclusions of Law, they are adopted as such, and to the extent any Conclusions of Law constitute Findings of Fact, they are so adopted.

equity. Oded Simchon, Samuel Simchon's brother, contributed \$2,500 and obtained 25% of the original equity. Rebecca Simchon and Levy Simchon, Simchon's mother and father respectively, each contributed \$2,000 and obtained 20% of the original equity.

2. At the time the petition was filed, Simchon was Debtor's President, was a member of its board of Directors, and owned 41% of Debtor's common stock. Levy Simchon served as Debtor's Vice President, was a member of its Board of Directors, and was the owner of 20% of Debtor's common stock. Rebecca Simchon served as Debtor's Secretary, was a member of its Board of Directors, and owned 20% of Debtor's common stock. Oded Simchon was Debtor's Treasurer, was a member of its Board of Directors, and owned 19% of Debtor's common stock.

3. On August 19, 1998, an involuntary petition for relief under Chapter 7 of the Bankruptcy Code was filed against Debtor by three creditors. Debtor did not contest the filing of the petition, and, on September 4, 1998, Debtor filed a stipulation of consent of the relief sought. An Order of Relief was entered on September 9, 1998, and the following day Robert F. Anderson was appointed to act as the Trustee in this case.

4. Historically, Debtor had been a very successful company. Debtor's audited financial statement prepared by Elliot Davis & Company, LLP for the fiscal period ending on September 30 of 1995, 1996, and 1997 reflect the following information:

	<b>Fiscal Year Ending September 30, 1995</b>	<b>Fiscal Year Ending September 30, 1996</b>	<b>Fiscal Year Ending September 30, 1997</b>
<b>Gross Revenues</b>	\$20,778,242	\$19,111,058	\$12,876,989
<b>Net Income</b>	\$2,269,301	\$571,824	\$6,346
<b>Total Assets</b>	\$7,141,531	\$8,563,263	\$7,194,178

<b>Inventory</b>	\$4,710,563	\$4,055,987	\$4,548,339
<b>Shareholders' Equity</b>	\$2,837,479	\$2,144,303	\$1,930,649

5. The final in-house balance sheet which Debtor prepared was dated June 30, 1998, less than two months prior to the filing of the involuntary petition. The balance sheet indicates total assets at that time of \$8,354,051, including inventory in the amount of \$4,785,368. The shareholder's equity amounted to \$1,501,322.

6. Debtor's financial downturn was due to a large extent to competitors moving offshore to take advantage of the North Atlantic Free Trade Agreement ("NAFTA") and other treaties which allowed cut parts to be sewn into finished goods in foreign countries for a fraction of the domestic labor cost. By the end of 1996, essentially all of Debtor's competitors had moved offshore. In late 1995, Debtor also experimented with moving offshore by contracting with a Mexican manufacturer; however, the first attempt to move sewing operations offshore proved to be unsuccessful. The contractor failed to timely deliver the products and the quality of the work was not satisfactory; as a result, Debtor lost a large account and decided to abort the move. Thereafter, Debtor continued to search the industry for other potential offshore locations and finally concluded that Honduras would be an appropriate place for the establishment of an offshore sewing operation. After consulting with Elliot Davis & Company, LLP and an Honduran law firm, Simchon was advised that the appropriate method for establishing the offshore sewing operation was to create a Honduran corporation owned by him and another individual. The professionals' advice was based on the following: First, Debtor, as a subchapter S corporation, could not itself own another corporation. Second, the establishment of a separate

corporation in Honduras would shield Debtor's assets from claims against the Honduran operation. Lastly, the Honduran government required a domestic corporation to be established to do business in Honduras.

7. Based on the advice, STKH was incorporated on or about March 17, 1997. Simchon owns 99% of the interest in STKH and his father, Levy Simchon, owns the remaining 1%.

8. Elliot, Davis & Company, LLP<sup>3</sup> suggested many alternatives regarding the amount of profit which should be made by STKH. The option which was ultimately chosen by Debtor was the one which provided for a minimum amount of profit to be made by STKH. Although the option was chosen whereby STKH would make a minimal profit as a start-up operation, STKH operated at cost. Debtor paid all of STKH's costs of operation through wire transfers either into STKH's account or directly to STKH's landlord or utility provider. In exchange, STKH provided sewing services at a rate significantly less than what could be obtained by Debtor in the United States.

9. On or about March or April of 1997; Debtor began shipping equipment, inventory, and money to STKH.

10. As Debtor's financial condition continued to deteriorate, on May 25, 1998, Debtor's principal lender, SouthTrust Savings ("SouthTrust"), gave Debtor and Simchon oral notice that the line of credit it had provided Debtor would be terminated. On June 17, 1998, SouthTrust gave written notice that the line of credit had been terminated as of June 1, 1998. As a result of the termination, Simchon contacted the corporation's attorney, Billy J. Garrett, Jr., who had been counsel for Debtor since July 1997 and continued to represent it up to the date of filing of the

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<sup>3</sup> Elliott, Davis & Company, L.L.P. is an established South Carolina firm of Certified Public Accountants.



involuntary bankruptcy petition in August of 1998. At the time the line of credit was terminated, Debtor had substantial work orders which could not be fulfilled without an infusion of cash. Mr. Garrett advised Simchon that, in his opinion, Simchon should purchase products from Debtor to provide it with immediate cash. He further advised Simchon not to loan money to Debtor because the repayment of such a loan might constitute a voidable preference if Debtor subsequently filed bankruptcy. Mr. Garrett also advised Simchon that he should not profit on the purchases, but that he should lose \$10.00 on each transaction so that they would not constitute fraudulent transfers. Lastly, Mr. Garrett suggested that Simchon should make certain that the sales transactions were well documented and easily traced so that no one could later question the propriety of the transactions.

11. Simchon initially planned to establish a corporation by the name of STK, Inc. to purchase Debtor's inventory so that he could continue sales to its existing customers. The initial Articles of Incorporation for STK, Inc. were filed but returned by the Secretary of State's office because the name was too similar to another corporation already registered. Thereafter, the name Southern Textile Knitters of Greenwood, Inc. was chosen and the corporation was established.

12. After notification that the line of credit was terminated, Mr. Garrett met with SouthTrust's representatives to attempt to negotiate with them. At that time, SouthTrust was informed that Simchon was purchasing inventory for cash. The proposal that Mr. Garrett presented to SouthTrust was to allow the lender to continue to collect the accounts receivable in satisfaction of its debt and to allow Simchon to purchase the equipment for a release price to be paid to SouthTrust. The inventory which was also subject to SouthTrust's lien would remain an asset of Debtor and be sold as finished goods for the benefit of the unsecured creditors. Mr. Garrett advised Simchon to obtain the approval of the proposed plan from his unsecured

creditors. On or about August 10, 1998, Simchon met with a group of the unsecured creditors; however, the plan was rejected, and three of those creditors filed the involuntary petition on August 19, 1998.

### DEBTOR'S SCHEDULES

13. On or about September 10, 1998, Debtor filed its bankruptcy Schedules and Statement of Financial Affairs. The Schedules were signed by Simchon, as the President of Debtor, and reflected the following information:

SCHEDULE	VALUE
<u>Schedule A (Real Property)</u>	\$175,000.00
Building and Land in Chester, South Carolina	
<u>Schedule B (Personal Property)</u>	
1. Cash	\$0
2. Checking Accounts	\$0
9. Insurance Policy	\$8,936.52
15. Accounts Receivable	\$991,400.39
19. Other Debts owed to Debtor	\$4,521.86
20. Unfiled Insurance Claim	value unknown
23. Automobiles	\$68,500.00
26. Office Equipment	\$152,240.57
27. Machinery (warehouse)	\$229,628.29
Machinery (sewing)	\$184,881.00
Machinery (leased)	\$247,384.00
28. Inventory	\$1,000,000.00 (estimate)
Total Personal Property	\$2,884,492.63
Total Real Estate	\$175,000.00
<b>Total Assets</b>	<b>\$3,062,492.63</b>
Schedule D, Secured Creditors	\$1,926,471.01
Schedule E, Priority Creditors	\$318,164.72
Schedule F, Unsecured Creditors	\$2,806,791.15
<b>Total Creditors Claims</b>	<b>\$5,051,426.88</b>

14. Paragraph 28 of Schedule B, which reflected an estimated value of \$1,000,000 for inventory, also reflected that "Debtor is in the process of taking inventory." With respect to paragraph 26, dealing with office equipment, furnishing, and supplies; and paragraph 27, dealing with machinery, fixtures, equipment, and supplies used in business, the Schedules reflect that Debtor was "Preparing List."

15. Sam Lovell ("Lovell"), the Trustee's liquidator, met with Simchon on or about September 13, 1998 to discuss the Trustee's collection and liquidation of Debtor's assets. Lovell spent several hours with Simchon driving to Debtor's facilities and inspecting Debtor's former operations in Old Fort, North Carolina and Chester, South Carolina.

16. At the request of Lovell, Simchon prepared a list of Debtor's equipment and inventory at various locations which had not been itemized in Debtor's Schedules. On September 15, 1998, Simchon sent Mr. Lovell a letter by telefax which included the list of the various assets which had yet to be included in the Schedules. The list indicated that Debtor had yarn inventory at locations in Chester, Ninety-Six, Ramseur, South Carolina; as well as Statesville, Marieta, North Wilkesboro, and Norwood, North Carolina. The total cost of the inventory amounted to approximately \$503,310.00.

#### **LIQUIDATION OF ESTATE'S ASSETS**

17. As of the date of trial, the Trustee had liquidated the following assets:

##### **Listed Assets Liquidated by Trustee:**

<b>Assets</b>	<b>Schedule Value</b>	<b>Received by the Estate</b>
Schedule A, Real Property: Building and Land in Chester, South Carolina	\$175,000.00	\$145,000.00

<b>Schedule B, Personal Property:</b>		
1. Cash	\$0	\$0
2. Checking Accounts	\$0	\$0
9. Insurance Policy	\$8,936.52	\$0
15. Accounts Receivable	\$991,400.39	\$238,447.23
19. Other Debts owed to Debtor	\$4,521.86	\$1,100.00
20. Unfilled Insurance Claim	Value Unknown	\$0
23. Automobiles	\$68,500.00	\$23,000
26. Office Equipment	\$152,240.57	\$8,875.00
27. Machinery (warehouse)	\$229,628.29	\$9,050.00
Machinery (sewing)	\$184,881.00	\$82,295.00
Machinery (leased)	\$247,384.00	\$0
28. Inventory	\$1,000,000.00 (estimate)	\$326,550.00

**Unlisted Assets Liquidated by Trustee:**

<b>Assets</b>	<b>Schedule Value</b>	<b>Received by the Estate</b>
Preferences	N/A	\$6,500.00
Forklift	N/A	\$3,400.00
Phone System	N/A	\$19,100.00
Other	N/A	\$5,095.75

18. The following reflects the disbursements of the liquidated funds to various creditors:

SouthTrust, Secured Creditor Real Estate	\$577,724.58
Mortgage, Secured Creditor	\$112,000.00
Total Payments to Secured Creditors	\$689,724.58
Administrative Expenses and Other Expenses	\$108,751.81

19. The claims register indicates that the following claims have been filed:

Secured Claims	\$2,201,824.01
Priority Unsecured Claims	\$64,847.95
General Unsecured Claims	\$3,262,505.26
<b>Total Claims</b>	<b>\$5,529,177.22</b>

20. As of the date of trial, certain inventory and equipment of Debtor had yet to be liquidated, including certain equipment in Honduras and a compressor located in Chester, South Carolina. Inventory that had not been liquidated included inventory located at B & J Knits, Supreme Knits, Knit Creations, Swag Knits, Luray Textiles, and G & M Knitting. Furthermore, some of the inventory at the Chester, South Carolina facility had been abandoned by the Trustee.

#### **EQUIPMENT TRANSFERRED TO HONDURAS**

21. In conjunction with the establishment of STKH, certain equipment owned by Debtor was shipped to Honduras to be used by STKH to sew Debtor's cut parts into finished goods.

22. Between March or April of 1997 and October of 1997, Debtor transferred certain existing and newly acquired manufacturing equipment to STKH.

23. Title to the equipment was never transferred to STKH, and this equipment remains property of the bankruptcy estate.

24. The transfer of the equipment was itemized on United States Custom invoices.

25. The equipment was subject to security interests or leases between Debtor and Amplicon Financial, Park Leasing, and South Trust; all of which have been assigned to Bay Island Sportswear, Inc., a corporation owned 100% by Simchon. Bay Island Sportswear, Inc. claims a debt in the approximate amount of \$230,000 plus legal fees.

26. At the hearing on the Motion on Partial Findings pursuant to Fed. R. Bankr. P. 7052, heard after Plaintiff rested his case, the Trustee acknowledged that, as it relates to the transfer of equipment to STKH, he is only seeking it under the First Cause of action, which deals with turnover pursuant to §542 and, related to the turnover cause of action, conversion.

## **INVENTORY TRANSFERRED TO SAMUEL SIMCHON**

27. The SouthTrust line of credit was the source of substantially all of the day-to-day operating cash of Debtor. Upon receiving oral notification of the termination of SouthTrust's line of credit on May 25, 1998, Simchon immediately contacted Billy Garrett, counsel to Debtor, and met with him to discuss the options for Debtor. As a result of that meeting and the advice given him by Mr. Garrett, Simchon decided to purchase products from Debtor for cash in an effort to alleviate Debtor's cash flow problem. Inventory was purchased by Simchon from Debtor to be resold to a to-be-formed corporation, STKG.

28. On May 27 and 28, 1998, Simchon gave Debtor four checks totaling \$105,000. Each check indicating that the transfer was a "loan." The funds were deposited in Debtor's bank account on May 29, 1998. The first advance of funds to Debtor totaled \$105,000 but came from four separate checks: one drawn from Old Fort Industrial Park, L.L.C.'s account in the amount of \$30,000; two checks in the amounts of \$15,000 and \$30,000 drawn from Center Pointe Construction, Inc.'s account; and the last check in the amount of \$30,000 drawn from Samuel Simchon's personal bank account.

29. Center Pointe Construction, Inc. is a corporation owned by Renee Simchon, Simchon's wife.

30. Old Fort Industrial Park LLC is a limited liability corporation organized under the laws of the State of North Carolina. Simchon owns 96% of the corporation.

31. On June 4, 1998, Simchon gave Debtor a check in the amount of \$31,000. The check was drawn from Simchon and his wife's bank account. The check indicates "loan to STK."

32. On June 11, 1998, Simchon gave Debtor a check in the amount of \$300,000. The check was drawn from Simchon's personal account and indicated that it was a "loan."

33. On June 11, 1998, Simchon gave Debtor a check in the amount of \$55,000 which was drawn from his personal bank account but failed to indicate whether the advance was a “loan.”

34. On June 12, 1998, Simchon gave Debtor a check in the amount of \$100,000. The check was drawn from Simchon’s personal bank account and indicated that it was a “loan.”

35. On June 26, 1998, Simchon gave Debtor a check in the amount of \$42,000 which was drawn from his personal account but did not indicate whether the advance was a “loan.”

36. On July 17, 1998, Renee Simchon gave Debtor a check in the amount of \$42,000 which was drawn from Old Fort Industrial Park, L.L.C.’s account. The check indicated that it was for “Purchase Merchandise.”

37. On July 24, 1998, Renee Simchon gave Debtor a check in the amount of \$32,000 drawn from Old Fort Industrial Park, L.L.C.’s account which indicated that it was for “Purchased Merchandise.” On the same date, Simchon gave Debtor a check in the amount of \$5,000.00 which was drawn from his joint bank account with his wife, Renee Simchon. The \$5,000 check indicated that it was for “Purchase Garments.”

38. Between July 27 and August 14, 1998, Samuel Simchon gave five checks in the amount of \$60,000, \$25,000, \$28,300, \$19,573, and \$5,114.74. All five checks were drawn from STKG’s account and most of the checks indicate that they were for the purchase of merchandise.

39. In summary, the following amount of money was provided to Debtor by the following entities and respective accounts:

<b>Old Fort Industrial Park LLC</b>	\$104,000
<b>Center Pointe Construction, Inc.</b>	\$45,000
<b>Renee Simchon and Samuel Simchon</b>	\$36,000
<b>Samuel Simchon</b>	\$527,000

<b>STKG</b>	\$137,987.74
<b>TOTAL</b>	\$849,987.74

40. These payments were initially booked on Debtor's books and records as a loan from Simchon to Debtor. Debtor's bookkeeper, Sam Gladstone, testified that he was initially confused by the description on the check as "loans" or "loans to STK" and assumed that they represented loans to Debtor. When Simchon realized how the entries were being booked, Gladstone corrected it. Thereafter, each check written to purchase inventory used the phrase "Purchase garments", "Purchase t-shirts", or "Purchase merchandise;" and none were booked as loans after June 26, 1998.

41. The purchase of inventory by Simchon was evidenced by invoices which were prepared within a couple of weeks of the deposits of the checks in Debtor's account. The invoices are dated from May 28, 1998 to July 31, 1998 and total \$849,967.64,<sup>4</sup> and they indicate that they were "pre-paid."

42. The sales of inventory from Debtor to Simchon were not reflected in Debtor's books and records by a respective reduction in inventory.

43. Subsequent to the purchase of the inventory from Debtor, Simchon transferred the same inventory to STKG. No invoices were created to evidence the transfer of inventory from Simchon to STKG.

44. STKG then ultimately sold the inventory to customers. The sale to customers is evidenced by invoices dated from June 30, 1998 to September 11, 1998. STKG sold the

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<sup>4</sup> The Court cannot reconcile the discrepancy between the total amount of the checks drawn and the total amounts reflected in the invoices.



inventory to Debtor's customers for \$933,036.98.<sup>5</sup>

45. The inventory which was purchased by Simchon was not physically moved from Debtor's location. When the goods were purchased by Simchon, they were identified and segregated in Debtor's headquarters in a distinct area from the rest of Debtor's inventory. All of the inventory was segregated on or before July 31, 1998.

46. The format of the invoices evidencing the sales to Simchon was different from the standard format used by Debtor because the invoices were prepared on Excel software instead of the Edge based software system which Debtor previously used in the ordinary course of business. At trial, Simchon testified that the invoices were not prepared on Debtor's ordinary records for several reasons: First, as advised by Mr. Garrett, Simchon wanted to be able to easily trace the sales to him. Second, most of the employees knowledgeable about the Edge System had been laid off or left Debtor's employment. Third, the invoices from STKG to the ultimate customer could not have been produced on the Edge System because the "payable to" entry could not be changed from "Southern Textile Knitters, Inc." to "Southern Textile Knitters of Greenwood, Inc." Finally, because the information input on the invoices from Debtor to Simchon was virtually identical to the information input on the invoices from STKG to the ultimate customers, it saved time to input the information for the invoices from Debtor to Simchon and duplicate them for the invoices from STKG to the customers.

#### **MISAPPROPRIATION OF INVENTORY**

47. Between March of 1997 and July of 1998, Debtor sent cut fabric to STKH to be sewn into finished garments.

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<sup>5</sup> The amount represents the total of the invoices from STKG to various customers, but it also includes necessary expenses such as packing and shipping.

48. United States Custom invoices document the shipment of equipment and inventory to STKH. The invoices reflect that 1,414,101 cut parts were sent to STKH between March 6, 1997 and July 10, 1998. Along with the cut parts shipped to Honduras; other items included buttons, collars, cuffs, neck tape, labels and other items necessary to sew cut parts into finished goods.

49. Even though the inventory was shipped to STKH, it remained the inventory of Debtor at all times, and the title to the inventory did not transfer to STKH.

50. Between June of 1997 and July of 1998, United States Customs invoices were also prepared for all finished goods which were created from Debtor's cut parts. The invoices reflect that approximately 110,000 dozen finished goods were returned to the United States. Debtor's cost for the sewing of the cut parts into finished garments amounted to \$800,000.<sup>6</sup> The evidence introduced at trial shows that if the goods had been sewn in the United States it would have cost Debtor \$1,645,864.47 if done by a third party contractor or \$1,523,364.38 if done by Debtor in its domestic facilities.

51. Approximately 90,000 cut parts were not sewn into finished goods and returned to Debtor. These cut parts were either sold by Debtor in August of 1998, damaged in the sewing process, or on hand at STKH.

#### **TRANSFER OF EXCEL STOCK AND SIMCHON'S SALARY**

52. On or about May of 1995, Debtor purchased 1/3 equity interest in Excel Dyeing and Finishing, Inc. ("Excel") for approximately \$75,000. Debtor purchased the interest due to an agreement with Excel whereby Excel would provide dyeing and finishing services to Debtor at a

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<sup>6</sup> DuRant concluded that the cost to Debtor was approximately \$925,000. The Court notes that regardless of whether the Court accepts \$925,000 or \$800,000 as the cost to Debtor of the sewing operations provided by STKH, Debtor saved at least \$600,000 in production costs.

reduced rate following Debtor's capital infusion.

53. At a directors' meeting on May 16, 1996, Debtor's directors discussed giving the stock to Simchon as a "bonus" because Excel wanted to convert to a Subchapter S corporation, which required the stock to be held by an individual.<sup>7</sup>

54. Debtor ultimately transferred the stock to Simchon in October of 1997 as a \$1,000 bonus.

55. Debtor continued to receive the benefit of the discounted services by Excel even after the stock was given as a "bonus" to Simchon.

56. Although Elliott Davis & Company, LLC valued Excel's stock at \$107,000 in the September 1997 audit, Simchon testified that the stock is worth substantially less than that for several reasons. Soon after September 30, 1997, a major customer of Excel filed bankruptcy which not only caused sales to decline but resulted in an unpaid receivable in the amount of \$352,000. In addition, within one year, Excel lost its account with Debtor and it holds a substantial unpaid claim as a result of the bankruptcy.

57. Up to the end of July 1998, Simchon also received a weekly salary from Debtor.

#### **OPERATING FUNDS TO STKH**

58. Debtor funded all capital and operating expenses incurred by STKH from its inception through the end of July. The funds were transferred to STKH to pay rent, electricity, payroll, and other operating expenses for the sewing of Debtor's cut parts into finished goods. As the wire transfer receipts indicate, no funds were transferred after July 28, 1998.

59. The receipts of the wire transfers from Debtor's account at Greenwood Bank & Trust to

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<sup>7</sup> Debtor's Minutes of Meeting of Shareholder held on May 16, 1996 reflect that, among other issues, the following was discussed: "Discussed Sam Simchon purchasing Excel stock at reduced price as bonus. Excel wanted to file sub S election and Sam is the only one on the personal guarantee for \$900,000.00."

STKH reflect the following amounts being transferred on the respective dates:

**WIRE TRANSFERS FROM FEBRUARY 25, 1997 TO SEPTEMBER 30, 1998**

<b>Date</b>	<b>Plant</b>	<b>Rent</b>	<b>Utilities</b>
02/25/97		19,513.86	
03/20/97	25,000		
04/04/97	25,000		
04/04/97			535.58
05/06/97		9,525.93	
05/07/97			2,667.57
06/05/97	25,000		
06/16/97		9,525.93	
06/16/97			4,291.63
07/03/97	8,000		
07/23/97			3,989.31
07/23/97		9,525.93	
07/28/97	25,000		
08/07/97	25,000		
08/11/97		9,525.93	
08/14/97			4,583.71
09/18/97	11,000		
09/18/97		9,525.93	
09/25/97			4,987.50
09/30/97	15,000		
<b>TOTAL</b>	<b>\$159,000</b>	<b>\$67,143.51</b>	<b>\$21,055.30</b>

**WIRE TRANSFERS FROM OCTOBER 9, 1997 TO DECEMBER 18, 1997**

<b>Date</b>	<b>Plant</b>	<b>Rent</b>	<b>Utilities</b>
10/09/97	5,000		
10/24/97	10,000		
10/29/97	5,000		
11/04/97		9,525.93	
11/04/97			138.44
11/04/97			4,469.22
11/06/97	9,000		
11/13/97	7,000		
11/20/97	8,000		
11/26/97	11,000		
11/28/97			4,793.85
11/28/97		9,525.93	
12/01/97	5,000		
12/11/97	15,000		
12/15/97	15,000		
12/18/97			5,122.53
12/18/97		9,525.93	
<b>TOTAL</b>	<b>\$90,000</b>	<b>\$28,577.79</b>	<b>\$14,524.04</b>

**WIRE TRANSFERS FROM OCTOBER 9, 1997 TO DECEMBER 18, 1997**

<b>Date</b>	<b>Plant</b>	<b>Rent</b>	<b>Utilities</b>
01/08/98	17,500		
01/16/98	7,300		
01/16/98		9,525.93	

01/16/98			3,416.60
01/22/98	10,000		
01/28/98	11,500		
02/04/98	6,000		
02/12/98	8,000		
02/18/98	8,000		
02/18/98		9,525.93	
02/18/98			4,483.04
02/25/98	8,000		
03/04/98	8,000		
03/11/98	8,000		
03/18/98		9,525.93	
03/19/98	8,000		
03/26/98	8,000		
03/31/98	20,000		
04/09/98	3,000		
04/15/98			4,569.33
04/15/98	10,000		
04/24/98	10,000		
04/29/98			5,424.32
04/29/98		9,525.93	
04/29/98	26,000		
05/14/98	14,000		
05/19/98	11,000		
05/20/98		9,525.93	
05/20/98			5,785.22
05/29/98	15,000		

<b>06/04/98</b>	15,000		
<b>06/12/98</b>	15,000		
<b>06/18/98</b>	5,000		
<b>06/22/98</b>	37,127.50		
<b>06/26/98</b>	6,380.96		
<b>07/01/98</b>		9,525.93	
<b>07/09/98</b>	25,000		
<b>07/24/98</b>	10,000		
<b>07/28/98</b>			7,250.79
<b>TOTAL</b>	<b>\$330,808.46</b>	<b>\$57,155.58</b>	<b>\$30,929.30</b>

#### SUMMARY

Total wire to STKH	\$579,808.46
Total Spent on Rent	\$152,876.88
Total Spent on Utilities	\$66,508.64
<b>TOTAL</b>	<b>\$799,193.98</b>

#### TRANSFER OF DEBTOR'S BUSINESS

60. STKG was established as a means of assisting Debtor through its financial crisis, and the corporation closed down soon after it sold all of the products which Simchon purchased from Debtor and conveyed to it.

61. Some of Debtor's customers became customers of STKG and some of Debtor's former employees worked for STKG.

62. STKG did business in the same location as Debtor and used the same telephone number as Debtor, but it is no longer in operation.

63. STKG's Income Tax Returns show that the corporation lost considerable amounts of money during its short existence.

64. STKH also lost considerable amounts of money. STKH's balance sheets reflect the following:

	<b>December 31, 1997</b>	<b>August 31, 1998</b>	<b>December 31, 1998</b>
<b>Total Income</b>	\$362,641.77	\$387,376.62	\$634,890.10
<b>Gross Profit</b>	\$117,628.73	\$184,324.40	\$207,319.10
<b>Total Expenses</b>	\$151,703.22	\$280,237.06	\$387,687.92
<b>Net Ordinary Income</b>	(\$34,074.49)	(\$93,027.46)	(\$180,368.83)
<b>Assets</b>	\$25,786.05	\$55,402.85	\$46,429.56
<b>Liabilities</b>	\$59,319.96	\$181,157.58	\$257,869.68
<b>Equity</b>	(\$33,533.92)	(\$125,754.74)	(\$211,440.12)

65. STKH's balance sheet as of December 31, 1999 reflects total assets of \$14,711.15, total liabilities of \$372,610.26, and total equity of <\$357,899.11>.

66. After STKH stopped doing business with Debtor, it did a small amount of business with Toyoshima, and thereafter has been doing contract sewing for Skip's Sewing, which is not a customer of Debtor.

#### **RENT DUE**

67. Defendants acknowledge that STKH entered into a lease agreement with Debtor for the sewing equipment that Debtor transferred to Honduras.<sup>8</sup>

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<sup>8</sup> Even though Defendants have acknowledged the existence of an agreement between STKH and Debtor, they never produced a copy of the actual lease or contract. The Trustee thus relies on Debtor's audited financial statements prepared by Elliot Davis & Co. LLP to determine the amount due under the lease.



68. STKH was to pay \$3,000 per month for the equipment in its possession.
69. No monthly payments were ever made by STKH.

### **CONCLUSIONS OF LAW**

#### **a. Misappropriation of Inventory**

The Trustee alleged that approximately \$2.4 million worth of inventory was misappropriated by transferring it to STKH between July 31, 1998 and the date the petition was filed on August 19, 1998. George DuRant, the Trustee's CPA, started his analysis by determining that as of July 31, 1998, Debtor reported an inventory of \$3,721,725, composed of the following:

<b>Inventory</b>	<b>Quantity</b>	<b>Unit Value</b>	<b>Value</b>
Yarn	187,467 lbs.	2.85	\$535,068
Devalued Yarn	0 lbs.	1.00	\$0
Greige Goods	5,131 lbs.	3.33	\$17,086
Piece goods	543,152 yds.	2.27	\$1,232,955
Work in Process	167,758 pieces	2.50	\$419,395
Finished Goods	416,819 pieces	3.64	\$1,517,221
<b>TOTAL</b>			<b>\$3,721,725</b>

The inventory was subsequently liquidated and the following proceeds were received from the sale:

<b>Inventory</b>	<b>Quantity</b>	<b>Unit Value</b>	<b>Value</b>
Containers 1-8 (Rolls)	210,945 lbs.	.85	\$179,303.25
Chester Inventory	441 lbs.	.50	\$220.50
Yarn (Ramseur)	45,499 lbs.	.70	\$31,849.30

Fabric (Ramseur)	5,493.4 lbs.	.70	\$3,845.38
Shirts (Miami)	23,196	1.00	\$23,196.00
Shirts (Chester)	6,428	.70	\$4,499.60
Shorts (Chester)	7,667	.30	\$2,300.10
Yarn (Chester)	104,623 lbs.	.61	\$63,820.03
Cut Parts (Chester)	11,700	.15	\$1,755.00
Miscellaneous			\$13,316.40
<b>TOTAL</b>			<b>\$324,105.56<sup>9</sup></b>

In conceding that the Trustee's liquidation sales of \$324,105.56 did not represent a true picture of the value of the inventory, DuRant attempted to restate the Trustee's sales consistently with the manner in which Debtor's records were maintained and concluded that the Trustee's sales accounted for \$1,322,652.92, as shown below:

<b>Inventory</b>	<b>Quantity</b>	<b>Unit Value</b>	<b>Recalculated Value</b>
Containers 1-8 (Rolls)	210,945 lbs.	3.33	\$702,446.85
Chester Inventory	441 lbs.	3.33	\$1,459.71
Yarn (Ramseur)	45,499 lbs.	2.85	\$129,672.15
Fabric (Ramseur)	5,493.4 lbs.	3.33	\$18,293.02
Shirts (Miami)	23,196	3.64	\$84,433.44
Shirts (Chester)	6,428	3.64	\$23,397.92
Shorts (Chester)	7,667	3.64	\$27,907.88
Yarn (Chester)	104,623 lbs.	2.85	\$292,475.55

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<sup>9</sup> The Court cannot reconcile the discrepancy between the amount of inventory used by DuRant's analysis of misappropriated inventory and the amount listed on the chart of assets liquidated by the Trustee on page 10 of this Order.

Cut Parts (Chester)	11,700	2.50	\$29,250.00
Miscellaneous			\$13,316.40
<b>TOTAL</b>			\$1,322,652.92

From this analysis, and after taking into account a sale of goods in the amount of \$8,644 which took place in August of 1998, DuRant reached the conclusion that \$2,390,428.00 in inventory was unaccounted for.

Inventory on July 31, 1998	\$3,721,725
Less, August 1998 Sale	\$8,644
Less, the Trustee Sale at Cost	\$1,322,653
Unexplained inventory discrepancy	\$2,390,428

This Court finds that DuRant's analysis has been rebutted by Defendants, who have accounted for the inventory differently and have reconciliated the discrepancy which the Trustee attributes to misappropriation. First, Defendants have noted that by revaluing the Miscellaneous Inventory which DuRant carried over at the Trustee sale value to adjusting it to account for the manner that Debtor carried it on its books and records, the Trustee's sale value would have accounted for over \$200,000 of missing inventory.<sup>10</sup>

Second, Defendants pointed out that, in restating the value of the "Containers 1-8 (Rolls)", the Trustee utilized the per pound rate of \$3.33. However, Simchon testified and Defendants argue that the 210,945 pounds of "rolls" were neither yarn nor greige goods; instead, they were piece goods which were stated in yards, which should be revalued at a rate of \$4.30;

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<sup>10</sup> Defendants argue that the "miscellaneous" sales were of cut parts, which had a restated value of 16.66 times the Trustee's sale value; thus the restated value would have amounted to \$221,851.22.

thus accounting for an additional \$204,616.65 of the missing inventory.

Third, Defendants argue that Simchon testified at trial that inventory which had been sold to him by Debtor between May 28, 1998 and July 31, 1998, had not been removed from the inventory numbers carried on Debtor's books and records. In other words, despite the sale of approximately \$850,000 in inventory to Simchon, the inventory remained on Debtor's books and was included in the \$3,721,725 shown on the books as of July 31, 1998. Defendants argued that this explanation accounted for approximately \$1,790,000 of the missing inventory.<sup>11</sup>

In continuing to account for the missing inventory, Defendants argue that a portion of inventory, in existence at the time of the filing of the bankruptcy petition, had not been liquidated as of the date of trial. The inventory consisted of over 20,000 pounds of yarn which Lovell conceded was known to him and not liquidated by him. It was also uncontradicted at trial that some quantity of yarn and fabric had been damaged by water and that inventory existed in Virginia but had not been liquidated by the Trustee. Simchon testified that the value of the damaged yarn and fabric was between \$100,000 and \$200,000 and that an insurance claim was filed and should have been pursued by the Trustee. Finally, Defendants note that certain sales of goods by Debtor took place after July 31, 1998.

Furthermore, Defendants have rebutted DuRant's analysis and conclusions as to the missing inventory by providing an accounting for the inventory, classified by category, as

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<sup>11</sup> Due to the average cost basis of Debtor's accounting, the only way to fairly account for the sales to Simchon, which had not previously been deducted from Debtor's accounting records, was to ascertain the value upon which these goods were maintained on Debtor's records. The sales to Simchon consisted of 492,103 pieces of finished goods which had an average cost value of \$3.64, as shown on the July Inventory Cost Sheet; thus, these sales accounted for \$1,791,254 of the July 31, 1998 inventory that would not have been included in the Trustee's sales and which were not credited to the missing inventory.

follows:

**YARN INVENTORY  
JULY 31, 1998 AND THEREAFTER**

July 31, 1998 Ending Cost Inventory	187,467 Lbs
Less:	
Chapter 7 sale: Yarn (Ramseur)	(45,499 Lbs)
Chapter 7 sale: Yarn (Chester)	(104,623 Lbs)
Total Purportedly Unaccounted for	37,345 Lbs
<b>Offsite Yarn</b>	
B&J Knits	(3,383 Lbs)
Knit Creations	(3,300 Lbs)
Swag Knits	(4,932 Lbs)
Supreme	(8,035 Lbs)
Luray Textiles	(1,021 Lbs)
G&M Knitting	(5,000 Lbs)
<b>Total Unaccounted for After Offsite Yarn</b>	<b>11674 Lbs</b>
Toyoshima - Invoice 70 \$8,643.70	(6,649 Lbs)
Toyoshima - Invoice 71 \$4,998	(3,400 Lbs)
Toyoshima - Invoice 79 \$11,596 Deposited	(4,717 Lbs)
<b>Total Yarn Accounted</b>	<b>(3,092 Lbs)</b>
Chester Yarn Unsold	(5,000 Lbs)
Total Accounted for (Excess over book)	(8,092 Lbs)

**GREIGE GOODS  
JULY 31, 1998 AND THEREAFTER**

July 31, 1998 Ending Cost Inventory	5,131 Lbs
Less:	

Chapter 7 sale:	-0-
Total Unaccounted for	5,131 Lbs
Toyoshima - Invoice 74 \$13,208.55	5,408 Lbs
Total Accounted for (Excess over book)	(277 Lbs)

**PIECE GOODS INVENTORY  
JULY 31, 1998 AND THEREAFTER**

July 31, 1998 Ending Cost Inventory	543,152 Yards
Convert Yards to Pounds - Conversion Factor .55%	298,734 Lbs.
Chapter 7 sale: 8 Containers	(210,945 Lbs)
Chapter 7 sale: Fabric (Ramseur)	(5,493 Lbs)
Chapter 7 sale - Performance Embroidery	(441 Lbs)
<b>Total Unaccounted for</b>	81,855 Lbs
Chapter 7 Sale Performance Cleaning - Listed as Misc.	(28,000 Lbs)
Chapter 7 Sale Performance Cleaning- Listed as Misc.	(4,172 Lbs)
Toyoshima - Invoice 98 \$18,900 - 11,594 deposited 9/3	(12,600 Lbs)
Simchon - Invoice 105	(15,353 lbs)
<b>Total Unaccounted for</b>	<b>21,730 Lbs</b>
<b>Other pieces which were delivered to and sold by the Trustee</b>	<b>Unknown</b>

**WORK IN PROCESS/FINISHED GOODS INVENTORY  
JULY 31, 1998 AND THEREAFTER**

July 31, 1998 Ending Cost Inventory Work in Process	167,758 Pieces
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July 31, 1998 Ending Cost Inventory Finished Goods	416,819 Pieces
Total Pieces Inventory	584,577 Pieces
Less:	
Chapter 7 sale: Shirts Miami	(23,196 Pieces)
Chapter 7 sale: Shirts Chester	(6,428 Pieces)
Chapter 7 sale: Shorts Chester	(7,667 Pieces)
Chapter 7 sale: Cut Parts Chester (converted from lbs)	(24,375 Pieces)
<b>Total Unaccounted for</b>	<b>522,911 Pieces</b>
Toyoshima - Invoice 73 \$4,081.50 Deposited 8/28	(5,442 Pieces)
Toyoshima- Invoice 74 \$11,169.75	(14,893 Pieces)
Toyoshima - Invoice 76 \$19,881.00	(26,508 Pieces)
Toyoshima - Invoice 95 \$12,272.00	(6,136 Pieces)
Toyoshima - Invoice 72 \$9,134.25	(12,179 Pieces)
Toyoshima - Invoice 78, 80, 94 - \$14,159.75	(11,115 Pieces)
<b>Total Unaccounted for</b>	<b>446,638 Pieces</b>
Simchon Sales	(492,103 Pieces)
Total Accounted for	(45,465 Pieces)

In addition to accounting for the inventory on a unit basis, Simchon's testimony accounted for the inventory on a cash basis as well. The cash analysis of the inventory accounted for by Simchon is set out in the following paragraphs.

#### YARN

	Unites (Lbs)	Unit Cost	Dollars Accounted
July 31, 1998 Ending Cost Inventory	187,467		

Less:			
Chapter 7 sale: Yarn (Ramseur)	45,499	\$2.85	\$129,672.15
Chapter 7 sale: Yarn (Chester)	104,623	\$2.85	\$198,175.55
Total Purportedly Unaccounted for	37,345		
<b>Offsite Yarn</b>			
B&J Knits	3,383	\$2.85	\$9,641.55
Knit Creations	3,300	\$2.85	\$9,405.00
Swag Knits	4,932	\$2.85	\$4,056.20
Supreme	8,035	\$2.85	\$22,899.75
Luray Textiles	1,021	\$2.85	\$2,909.85
G&M Knitting	5,000	\$2.85	\$14,250.00
<b>Total Unaccounted for After Offsite Yarn</b>	11,674		
Toyoshima - Invoice 70 \$8,643.70	6,649	\$2.85	\$18,949.65
Toyoshima - Invoice 71 \$4,998	3,400	\$2.85	\$9,690.00
Toyoshima - Invoice 79 \$11,596 Deposited	4,717	\$2.85	\$13,443.45
<b>Total Yarn Accounted</b>	-3,092		\$523,093.15
Chester Yarn Unsold	5,000	\$2.85	\$14,250.00
<b>Total Accounted for</b>			<b>\$557,343.15</b>



### GREIGE GOODS

	Pounds	Unit Cost	Dollars Accounted
July 31, 1998 Ending Cost Inventory	5,131		
Less:			
Chapter 7 sale	-0-		
Total Unaccounted for	5,131 Lbs		
Toyoshima - Invoice 74 \$13,208.55	5,408	3.33	\$18,008.64
Total Accounted for	-277		

### PIECE GOODS

	Units (Lbs)	Unit Value	Dollars Accounted for
July 31, 1998 Ending Cost Inventory	543,152 Yards		
Convert Yard to Pounds- Conversion factor .55%	298,734 Lbs.		
Chapter 7 sale: 8 Containers	210,945	\$4.12	\$869,093.40
Chapter 7 sale: Fabric (Ramseur)	5,493	\$4.12	\$22,631.16
Chapter 7 sale - Performance Embroidery	441	\$4.12	\$1,816.92
Total Unaccounted for	81,855		

Chapter 7 Sale Performance Cleaning - Listed as Misc.	28,000	\$4.12	\$115,360.00
Chapter 7 Sale Performance Cleaning - Listed as Misc.	4,172	\$4.12	\$17,188.64
Toyoshima - Invoice 98 \$18,900 - 11,594 Deposited 9/3	12,600	\$4.12	\$51,912.00
Simchon - Invoice 105	15,353	\$4.12	\$63,254.36
Total Unaccounted for	21,730		
<b>Other pieces which were delivered to and sold by the Trustee</b>	Unknown		
<b>Total Accounted for</b>			<b>\$1,141,256.48</b>

#### WORK IN PROGRESS AND FINISHED GOODS

	Pieces	Unit Cost	Dollars Accounted for
July 31, 1998 Ending Cost Inventory Work in Process	167,758 Pieces		
July 31, 1998 Ending Cost Inventory Finished Goods	416,819 Pieces		
Total Pieces Inventory	584,577 Pieces		
Less:			

Chapter 7 sale: Shirts Miami	23,196 Pieces	\$3.64	\$84,433.44
Chapter 7 sale: Shirts Chester	6,428 Pieces	\$3.64	\$23,397.92
Chapter 7 sale: Shorts Chester	7,667 Pieces	\$3.64	\$27,907.88
Chapter 7 sale: Cut Parts Chester (converted from lbs)	24,375 Pieces	\$2.50	\$60,937.50
<b>Total Unaccounted for</b>	<b>522,911 Pieces</b>		
Toyoshima - Invoice 73 \$4,081.50 Deposited 8/28	5,442 Pieces	\$2.50	\$13,605.00
Toyoshima- Invoice 74 \$11,169.75	14,893 Pieces	\$2.50	\$37,232.50
Toyoshima - Invoice 76 \$19,881.00	26,508 Pieces	\$2.50	\$66,270.00
Toyoshima - Invoice 95 \$12,272.00	6,136 Pieces	\$2.50	\$15,340.00
Toyoshima - Invoice 72 \$9,134.25	12,179 Pieces	\$3.64	\$44,331.56
Toyoshima - Invoice 78, 80, 94 - \$14,159.75	11,115 Pieces	\$3.64	\$40,458.60
<b>Total Unaccounted for</b>	<b>446,638 Pieces</b>		
Simchon Sales	492,103 Pieces	\$3.64	\$1,791,254.92
Total Accounted for	-45,465 Pieces		\$2,205,169.32

### SUMMARY

<b>Yarn</b>	<b>\$557,343</b>
<b>Greige Goods</b>	<b>\$18,008</b>

<b>Piece Goods</b>	<b>\$1,141,256</b>
<b>Work In Progress and Finished Goods</b>	<b>\$2,205,169</b>
<b>Total Inventory Accounted for</b>	<b>\$3,921,776</b>

The Trustee attempted to highlight for the Court some of the discrepancies that exist in Debtor's books and records. The Trustee argued that the commercial invoices evidencing the shipments to and from Honduras indicate a difference in value of approximately \$2.3 million supporting a claim of diversion of goods. In fact, while the total dollar amount for the invoices from Debtor to STKH reflect an amount of approximately \$2,607,342.96, the invoices documenting shipments from STKH to Debtor total \$329,356.78. However, Simchon's testimony at trial offered a plausible explanation for the discrepancies: First, approximately \$600,000 of the \$2.6 million is equipment at cost value which was shipped to STKH in March and April of 1997 to set-up STKH's sewing operations and which remains an asset of Debtor. Second, the \$2,607,342.96 figure includes thread, boxes, buttons, collars, cuffs, and other items which are customarily provided by the owner to the third party contractor to be used in the sewing operations. Third, even if the Trustee's argument on this issue were correct, Simchon testified that 110,000 dozen finished goods (approximately 1,320,000 finished goods) were returned to Debtor at a per-unit cost of \$3.64.

Taking all of the above explanations into consideration, the Court finds that the Trustee has not met his burden to prove that inventory was being sent to Honduras and diverted over time. Despite the fact that DuRant's analysis is logical, the Court finds that Defendants have offered a reasonable explanation which accounts for the alleged misappropriated inventory.

**b. Transfer of Debtor's Overall Business to Defendants**

The Trustee claims that Defendant fraudulently transferred Debtor's overall business to STKG and STKH. However, the Court finds that the Trustee's allegations do not withstand the evidence presented at trial. Whether the motivation behind the incorporation of STKG was to complete the sales to Debtor's existing customers in an attempt to reduce the balance due to Debtor's primary lender, South Trust, which Simchon has personally guaranteed; the evidence also indicates that STKG was established as a means of assisting Debtor through its financial crisis, and it was closed soon after it sold all of the products which Simchon purchased from Debtor and conveyed to it. The Trustee did not offer sufficient evidence to contradict any of the foregoing other than that a handful of Debtor's former employees worked for STKG for several months at Debtor's former headquarters and that one of Debtor's telephone numbers was assumed by STKG. The Trustee did present evidence that some of the customers of Debtor became customers of STKG; however, Simchon testified that those sales were in conjunction with his purchase of inventory and the resale of that inventory by STKG to infuse cash into Debtor and try to restructure its affairs. He testified that on or about August 10, 1998, he met with Debtor's creditors and proposed a plan whereby STKG could continue to fill the previous purchase orders of Debtor, thereby obtaining retail value for Debtor's inventory. Simchon testified that in preparing this proposed plan, he had made commitments to several of Debtor's customers. As soon as the commitments were fulfilled, STKG ceased doing business.

Similarly, as for STKH, evidence presented at trial showed that Debtor's cut parts shipped to STKH were sewn into finished garments and returned to Debtor. After STKH ceased to do business with Debtor, it did a small amount of business with Toyoshima and thereafter has been doing contract sewing for Skip's Sewing. Simchon testified that none of the employees of

STKH were Debtor's employees. The Trustee failed to present any other evidence to support his allegation that STKH and STKG misappropriated Debtor's business. Furthermore, there is no evidence that there presently is any significant ongoing business with STKG or STKH; in fact, STKG closed soon after the sales to Debtor's existing customers were completed, and STKH is presently doing some work for Skip's Sewing but it has not proven to be profitable. Therefore, the Court ultimately finds that the Trustee has not met his ultimate burden to prove that Debtor's business was transferred to STKG and STKH.

**c. First Cause of Action--Turnover of Assets Pursuant to §542 and Thirteenth Cause of Action- Rent Due by STKH.**

The First Cause of Action asserts that Defendants should be ordered to turnover the inventory, cash, equipment, and good will which was transferred to them. The Trustee bases the cause of action pursuant to §542 which provides in pertinent part:

(a) Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

The Court has already concluded that the Trustee did not meet his burden to prove that \$2.4 million worth of inventory was converted by Defendants and has further found that the evidence presented at trial did not support a finding that Debtor's business was transferred to either STKG or STKH. The only property with value to the estate in this case is the equipment which was transferred to STKH. The evidence presented at trial showed that between March or April and October of 1997, Debtor transferred certain existing and newly acquired manufacturing equipment to STKH, which was to be used by the Honduran company to sew Debtor's cut parts

into finished goods. The title and ownership to the equipment was never transferred to STKH and remains property of the bankruptcy estate.

Defendants argue that the property is of inconsequential value to the estate due to the fact that it is under lien to Bay Island in the approximate amount of \$230,000 plus attorney's fees. See, e.g., Tricontinent Shipping & Terminal Serv., Inc. v. Seidle (In re American Trading & Shipping, Inc.), 24 B.R. 32, 37 (Bankr. S.D. Fla 1982) ("Although the \$30,000 pledged to Maynard if property of the Debtor's estate, it need not be turned over because, being fully encumbered, it is of inconsequential value or benefit to the Debtor's estate."). In arguing the inconsequential value of the equipment at issue, Simchon testified that, in his opinion, the value of the equipment transferred to STKH was in the range of \$200,000 to \$225,000. Even though it appears that the property at issue is under lien, the Court concludes that, due to the lack of credible evidence, it is not inclined to find that the equipment which was transferred to STKH is of inconsequential value to the estate; therefore, STKH and Simchon, as the principal owner of the Honduran corporation, are ordered to turnover the equipment to the Trustee within thirty (30) days of this Order.

The Thirteenth Cause of Action alleged in Plaintiff's Second Amended Complaint asserts that STKH owes Debtor rent in the amount of \$3,000 per month for the use of equipment since May 1, 1997. No lease agreement was ever presented into evidence; however, Defendants have acknowledged its existence and never disputed the amount due on the lease. There is no question that the rent owed by STKH is property of the estate within the meaning of §541(a)(6), which the Chapter 7 Trustee is entitled to receive under §542(b). In fact, the Court has already found that the equipment at issue is property of the estate; therefore, any rents due from the

property are also property of the bankruptcy estate.<sup>12</sup> Pursuant to §542(b):

Except as provided in subsection (c) or (d) of this section, an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor.

Therefore, the Court finds that STKH and Simchon should pay to the Trustee \$3,000 in monthly rent payments from May 1, 1997 to present, for a total of \$114,000, and continuing until the equipment is turned over. Therefore, the Court grants the First and Thirteenth Causes of Action as it relates to STKH and Simchon; but dismisses those causes of action against STKG.

**d. Second Cause of Action against Simchon and STKG--Preferential Transfers**

**Pursuant to §547(b)**

The Trustee's Second Cause of Action alleges preferential transfers pursuant to §547(b) as it relates to the transfer of inventory and Debtor's business to Simchon and STKG. Section 547(b) provides as follows:

Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property--

- (1) to or for the benefit of a creditor;
- (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
- (3) made while the debtor was insolvent;
- (4) made--
  - (A) on or within 90 days before the date of the filing of the petition; or
  - (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

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<sup>12</sup> Section 541(a)(6) provides that the bankruptcy estate is comprised, among other things, of "[p]roceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case."



(5) that enables such creditor to receive more than such creditor would receive if --

- (A) the case were a case under chapter 7 of this title;
- (B) the transfer had not been made; and
- (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

The purpose of preferential transfer law is to “assure that creditors are treated fairly and equitably in the distribution of the bankruptcy estate and are discouraged ‘from attempting to outmaneuver each other in an effort to carve up a financially unstable debtor.’” Hovis v. Stambaugh Aviation, Inc. (In re Air South Airlines), 247 B.R. 165, 170 (Bankr. D.S.C. 2000) (quoting Advo-Systems, Inc. v. Maxway Corp., 37 F.3d 1044, 1047 (4th Cir. 1994)). Section 547(f) emphasizes that the debtor is presumed to be insolvent, thus meeting the requirement of subsection (b)(3), on and during the 90 days prior to the date of filing bankruptcy. “The presumption requires the party against whom the presumption exists to come forward with some evidence to rebut the presumption, but the burden of proof remains on the party in whose favor the presumption exists.” Campbell v. Cannington (In re Economy Milling, Co., Inc.), 37 B.R. 914, 915 (D.S.C. 1983). Once the defendant has rebutted the presumption of insolvency, the trustee bears the ultimate burden of proving that the debtor was insolvent at the time of the transfer by the preponderance of the evidence. See §547(g); Lawson v. Ford Motor Co. (In re Roblin Indus. Inc.), 78 F.3d 30, 34 (2d Cir. 1996).

This Court has previously found that Debtor was solvent at least until July 31, 1998. Other than the foregoing, the Trustee offered no evidence as to when Debtor became insolvent; therefore, the Court is unable to conclude the exact date when any insolvency occurred, a burden which rests squarely on the Trustee once the §547(b) presumption of insolvency is rebutted. In this case, the Court finds that the transfers in question occurred on or before July 31, 1998;

therefore, the requirement of subsection (b)(3) have not been met. As to the transfer of inventory to Simchon, the invoices indicate that such transfers occurred between May 28, 1998 and July 31, 1998. No invoices were introduced into evidence to reflect the subsequent transfers of inventory from Simchon to STKG. The Trustee attempts to extend the dates of the subject transfers by requesting a finding from the Court that the goods purchased by Simchon and STKG were not transferred on the date of the invoices; rather, he seeks to have the Court find that the actual transfer date from Debtor to Simchon and subsequently to STKG is actually reflected on the invoices from STKG to its customers, which are dated between June 30, 1998 and September 11, 1998. However, the Court finds that the transfers at issue occurred on or before July 31, 1998, because all of the inventory had been segregated by that date. See S.C. CODE ANN. §36-2-401(1) (Law. Co-op. 1976).<sup>13</sup>

**e. Third And Ninth Causes of Action-- Section 548(a)(1)(A) and (B) and S.C. CODE ANN. §27-23-10.**

In his Second Amended Complaint, the Trustee sought a cause of Action against Defendants under §548 and S.C. Code Ann. §27-23-10. By Order entered on July 19, 2000, the

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<sup>13</sup> The Court notes that S.C. CODE ANN. §36-2-401(1) (Law. Co-op. 1976) provides that:

Title to goods cannot pass under a contract for sale prior to their identification to the contract (§36-2-501), and unless otherwise explicitly agreed the buyer acquires by their identification a special property as limited by this act. Any retention or reservation by the seller of the title (Property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest. Subject to these provisions and to the provisions of the chapter on secured transactions (Title 36, Chapter 9), title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties.

Court granted Defendant's Motion on Partial Findings pursuant to Fed. R. Bankr. P. 7052 on some of the causes of action. The transfers which remain at issue for the Trustee's assertions under §548(a)(1)(A) and S.C. Code Ann. §27-23-10 are the following: (1) transfer of salary to Simchon; (2) transfer of Excel stock to Simchon; (3) transfer of inventory to Defendants; (4) transfer of operating funds to STKH; and (5) transfer of overall business to Defendants. The transfers which remain at issue for the Trustee's assertion under §548(a)(1)(B) are the following: (1) transfer of inventory to Defendants; and (2) transfer of overall business to Defendants. As to the transfer of Debtor's overall business to STKG and STKH and misappropriation of \$2.4 million worth of inventory, the Court has already found that the Trustee's allegations do not prevail based upon the evidence presented at trial.

The Court will first address the issues in conjunction with the Statute of Elizabeth. The Trustee in this action seeks to avoid the subject transfers pursuant to §544(b) which provides:

(1) Except as provided in paragraph (2), the trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

As this Court has noted in Campbell v. Deans (In re J.R. Deans Co.), 249 B.R. 121 (Bankr. D.S.C. 2000), §544 "merely gives the trustee the status of a creditor under state law and allows non-bankruptcy law to determine the rights that accrue as a result of that created status." Id. at 129. In other words, the rights given to the Trustee pursuant to that section of the Bankruptcy Code are dependent on the rights of a creditor who has an allowable claim. Thus, the initial question is "whether there is a creditor with an allowed claim in this case who provides the trustee standing to assert the Statute of Elizabeth Action." Campbell v. Haddock (In re

Haddock), 246 B.R. 810, 814 (Bankr. D.S.C. 2000). In this case, the Trustee claims that he is standing in the shoes of Manpower Temporary Services, who filed a claim in the amount of \$110,538.28, which arose between December 21, 1997 and July 29, 1998.

The next issue is whether the requirements of the Statute of Elizabeth have been met.

The Statute of Elizabeth provides:

Every . . . conveyance of lands, tenements or hereditaments, goods and chattels or any of them . . . by writing or otherwise . . . which may be had or made to or for any intent or purpose to delay, hinder, or defraud creditors and others of their just and lawful actions, suits, debts, accounts, damages, penalties, and forfeitures must be deemed and taken . . . to be clearly and utterly void, frustrate and of no effect, any pretense, color, feigned consideration, expressing of use, or any other matter or thing to the contrary notwithstanding.

S.C. CODE ANN. § 27-23-10 (Law. Co-op. Supp. 1998). Fraudulent transfers may be set aside by existing creditors under either an actual fraudulent transfer theory or a constructive fraud theory. Under an actual transfer theory, the following elements have to be satisfied: (1) the transfer was made with the actual intent to defraud creditors; (2) the grantor was indebted at the time of the transfer; (3) the intent of the grantor can be imputed to the grantee. *See, e.g., Campbell v. Deans (In re J.R. Deans)*, 249 B.R. 121, 130-31 (Bankr. D.S.C. 2000); *Campbell v. Haddock (In re Haddock)*, 246 B.R. 810, 814 (Bankr. D.S.C. 2000). The actual fraud theory generally applies when the transfer was made for valuable consideration or for consideration which is found to be inadequate. *See, e.g. In re J.R. Deans*, 249 at 130-31 (citing *Royal Z Lanes, Inc. v. Collins Holding Corp.*, 524 S.E.2d 621 (S.C. 1999)). Under the constructive theory, where a transfer was made gratuitously, actual intent to defraud creditors is not a requirement; rather, the transfer is set aside if the creditor is able to establish the following: (1) the grantor was indebted to the

transferee at the time of transfer; (2) the transfer was voluntary; and (3) the grantor failed to retain sufficient funds to pay the debt to plaintiff. *Id.*

Generally, in causes of action dealing with the Statute of Elizabeth, the burden of proof, by clear and convincing evidence, rests with the Plaintiff. However, “when considering transfers to family members under either an actual or constructive fraud theory, the burden of proof shifts to the transferee to prove both that valuable consideration was exchanged between the parties and the bona fide of the transaction.” *In re Haddock*, 246 B.R. at 816; *see also Windsor Properties, Inc. v. Dolphin Head Const. Co.*, 498 S.E.2d 858, 861 (S.C. 1998) (“[W]here transfers to members of the family are attacked either upon the ground of actual fraud or on account of their voluntary character, the law imposes the burden on the transferee to establish both the valuable consideration and the bona fides of the transaction by clear and convincing testimony.”). In this case, the Court finds that burden of proof rests with Defendants to meet the requirements. *See Windsor Properties*, 498 S.E.2d at 861 (holding that in the case where the transfer in question was a conveyance of property from a corporation wholly owned by a husband to his wife, it was an “intra-family” transfer and “the law imposes on [wife] the burden of establishing by clear and convincing evidence that there was consideration and that the transaction was bona fide.”).

The Court finds that the testimony and documents introduced do not support a finding that the subject transfers were gratuitous or that the conveyances were intended to defraud creditors.<sup>14</sup> Defendants argue that Simchon, along with other companies owned by him and his

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<sup>14</sup> The court notes that even though it cannot determine with certainty whether the transfers were for equivalent consideration, if anything, they were for inadequate consideration, in which case the Court still would proceed with an analysis as to whether they were undertaken with actual intent to defraud.

wife, provided Debtor with approximately \$850,000 in capital by purchasing inventory and completing orders so that accounts receivable could continue to be generated. Of that amount of money, over \$231,000 was received and paid over by the Trustee to SouthTrust to pay down the outstanding obligation to the bank. As for the transfer of inventory and operating funds to STKH, it is clear that consideration was also paid in that the goods were sewn into and returned as finished parts. The invoices introduced at trial reflect that approximately 110,000 dozen of finished goods were returned to Debtor in the United States. Whereas the costs to Debtors for the sewing operation amounted to approximately \$800,000, if the goods had been sewn in the United States it would have cost Debtor more than \$1.5 million. Finally, as to the transfer of salary and Excel stock to Simchon, consideration was given in exchange for the income earned in that Simchon was the President of Debtor and the salary and Excel stock received was compensation and bonus for his services. Therefore, the Court finds that the evidence introduced by Defendants shows that consideration was given for the transfers and the Trustee has not sufficiently rebutted such arguments.

In order to determine whether actual fraud was involved in transfers at issue, courts generally infer fraudulent intent by considering the following “badges of fraud”:

“[T]he insolvency or indebtedness of the transferor, lack of consideration for the conveyance, relationship between the transferor and the transferee, the pendency or threat of litigation, secrecy or concealment, departure from the usual method of business, the transfer of the debtor’s entire estate, the reservation of benefit to the transferor, and the retention by the debtor of possession of the property.”

In re Haddock, 246 B.R. 810, 815 (Bankr. D.S.C. 2000) (quoting Coleman v. Daniel, 199 S.E.2d 74, 79 (1973)).

When considering the badges of fraud, the Court finds that they weigh in favor of

Defendants. The Court has previously found that the subject transfers took place prior to Debtor's insolvency. In fact, the Court has found that Debtor was solvent up to at least July 31, 1998. Furthermore, the transfers were not a result of actual or threatened litigation against Debtor; rather, the motivation beyond the conveyances is of a different nature. The transfer of inventory and operating funds to STKH appear to be a result of Debtor's attempt to move its sewing operation off-shore to reduce its costs, while the transfer of inventory to Simchon and STKG were an attempt pay down SouthTrust's loan which was guaranteed by Simchon and to aid Debtor during its financial downturn. No evidence was presented to the Court to show that the subject transfers occurred prior to any indication that an involuntary petition would be filed. The evidence presented also indicates that Debtor did not retain ownership of the inventory sold to Simchon and STKG. Even though the inventory that was purchased by Simchon was kept in Debtor's facilities until it was ultimately sold to third customers by STKG, it was segregated from the rest of Debtor's inventory. The evidence shows that STKG ultimately purchased the inventory and sold it to third parties at no profit in order to complete the sales to Debtor's existing customers and to pay down the balance due to SouthTrust. Finally, the transactions that took place between Debtor and STKH, STKG, and Simchon were disclosed as Debtor's corporate minutes reflect. Overall, the evidence does not sufficiently demonstrate an intent to defraud creditors.

The evidence also shows that Debtor's obligation to SouthTrust was substantially reduced as a result of the efforts of Defendants, that Debtor kept detailed records of the transfers, and assisted the Trustee in locating and accounting for all inventory. Moreover, the Court has previously concluded that none of Defendants misappropriated any inventory or misappropriated Debtor's business. Based on all of the foregoing, the Court finds these actions do not support the

Trustee's contentions of an intent to defraud, delay, or hinder creditors. Thus, Defendants have met their burden to prove that the transfers in question should not be set aside pursuant to the Statute of Elizabeth, found at S.C Code Ann. §27-23-10.

The Trustee has also asserted that the transfers were fraudulent conveyances under §548 which provides:

- (a)(1) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily--
  - (A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or
  - (B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
  - (ii)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
  - (II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or
  - (III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

The Trustee has asserted that Defendants fraudulently engaged in the transfers discussed above in violation of §548(a)(1)(A), which, like the Statute of Elizabeth, requires that the Trustee show that the subject conveyances were made with the actual intent to defraud, delay, or hinder Debtor's creditors.<sup>15</sup> As previously discussed in connection with the Statute of Elizabeth

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<sup>15</sup> Unlike §548(a)(1)(A), the Statute of Elizabeth reaches back to void transfers that took place even before one year prior to the filing of the bankruptcy petition; therefore, the Trustee asserted both causes of action to encompass any possible transfers even prior to the deadline established in §548(a)(1)(A).



claim, the Court finds that Defendants did not act with actual intent to defraud or hinder Debtor's creditors; therefore, the Court dismisses the §548(a)(1)(A) action asserted against Defendants.

Section 548(a)(1)(B), like preferential payments, requires that the Trustee demonstrate that the alleged fraudulent transfers occurred while Debtor was insolvent or resulted in Debtor's insolvency. The transfers at issue in this case took place prior to Debtor's insolvency.<sup>16</sup> The evidence indicates that the sale of the inventory gave Debtor almost \$850,000 in cash and generated revenue of approximately \$2,500,000 which was paid to SouthTrust during June, July, and August of 1998. For all of the foregoing reasons, the Court finds that the requirements under §548 and S.C. Code Ann. §27-23-10 have not been met; therefore, these causes of action against Defendants are dismissed with prejudice.

**f. Fifth Cause of Action against Simchon--Breach of Fiduciary Duty**

In the Fifth Cause of Action, the Trustee seeks a claim against Simchon, as President and Director of Debtor, for breach of fiduciary duty. More specifically, the Trustee asserts that Simchon caused a transfer of Debtor's assets in bad faith from Debtor to STKH, caused Debtor

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<sup>16</sup> The transfers at issue under this cause of action are: (1) the transfer of inventory to STKG; (2) the transfer of inventory to STKH; (3) transfer of inventory to Simchon; and (4) the transfer of Debtor's business to Defendants. As the Court previously discussed, the evidence does not support a finding that Debtor's business was fraudulently transferred to Defendants. Furthermore, the other transfers all took place while Debtor was still solvent. In fact, invoices reflect that cut parts were sent to STKH between March 6, 1997 and July 10, 1998. Furthermore, the Court has also found the Trustee's claims that inventory was misappropriated and taken to STKH after those dates are not supported by the evidence presented before the Court. The transfers of inventory to Simchon also occurred prior to July 31, 1998. Invoices which reflect Simchon's purchases of Debtor's inventory reflect dates between May 28, 1998 and July 31, 1998. Lastly, the Trustee failed to provide any evidence as to the exact date of the transfer of inventory to STKG and no invoices were created by Defendants to evidence the transfers of inventory from Simchon to STKG. The Trustee argued that the date of transfer should be the date when the inventory was ultimately delivered to third customers; however, as previously discussed in section (c) of this Order, the Court finds that that is not the appropriate date of transfer to consider.

to become insolvent, took corporate assets from Debtor, such as the Greenwood facility's fixtures, transferred Debtor's assets to STKH for no consideration, transferred Debtor's business to STKG, and usurped corporate opportunities. The Court finds that the Trustee has not met his burden to prove that Simchon's action constituted a breach of his fiduciary duty.

The general standard for directors is found at S.C. Code Ann. §33-8-300, which provides in pertinent part:

- (a) A director shall discharge his duties as a director, including his duties as a member of a committee:
  - (1) in good faith;
  - (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and
  - (3) in a manner he reasonably believes to be in the best interests of the corporation and its shareholders.
- (b) In discharging his duties a director is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by:
  - (1) one or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the matters presented;
  - (2) legal counsel, public accountants, or other persons as to matters the director reasonably believes are within the person's professional or expert competence; or
  - (3) a committee of the board of directors of which he is not a member if the director reasonably believes the committee merits confidence.
- (c) A director is not acting in good faith if he has knowledge concerning the matter in question that makes reliance otherwise permitted by subsection (b) unwarranted.
- (d) A director is not liable for any action taken as a director, or any failure to take any action, if he performed the duties of his office in compliance with this section.

The fiduciary duties owed by directors extend to creditors in very limited circumstances. In fact, the Fourth Circuit in Federal Deposit Ins. Corp. v. Sea Pines Co., 692 F.2d 973 (4th Cir. 1982) has stated:

In Koehler v. Black River Falls Iron Co., 67 U.S. (2 Black) 715, 720, 17 L. Ed. 339 (1892), the Court said that directors 'hold a place of trust and by accepting the trust are obliged to execute it with fidelity, not for their own benefit, but for the common benefit of the stockholders of the corporation.' . . . However, when the corporation becomes insolvent, the fiduciary duty of the directors shifts from the stockholders to the creditors.

Id. at 976-77. Thus, it is apparent that the elements of S.C. Code §33-8-300 are to be adhered to with respect to creditors once the fiduciary's corporation is insolvent. See McGuffin v. Barman (In re BHB Enterprises, LLC), C/A No. 97-01975-W; 97-80227-W (Bankr. D.S.C. 10/1/1998). As previously discussed, evidence shows that Debtor was solvent at least up to July 31, 1998; thus, up to at least that date, any fiduciary duty owed was owed to Debtor's stockholders rather than to creditors directly. The Court finds that Debtor was not insolvent at the time of the alleged transfers. In fact, the transfer of Debtor's equipment to Honduras took place between March or April and October of 1997; the transfer of inventory to STKH, as evidenced by invoices, took place between March 6, 1997 and July 10, 1998; the transfer of inventory to Simchon took place between May 28, 1998 and July 31, 1998; operating funds were transferred to STKH between February 25, 1997 and July 28, 1998; and Debtor's transfer of Excel stock to Simchon occurred in October of 1997. As to the transfer of inventory to STKG, no evidence was introduced reflecting the date of those transfers. Thus, it is clear that any fiduciary duty owed was owed to the stockholders of Debtor at least until July 31, 1998, and no sufficient evidence was presented to establish that the actions of Debtor's Officers and Board of Directors were carried out in their own interest, while disregarding the best interests of Debtor and its stockholders.

S.C. Code §33-8-300(b) states that a director is entitled to rely on information and opinions of an officer which the director reasonably believes to be reliable and competent. This

reliance is warranted, and satisfies the duty of care, as long as the director does not have knowledge of the matter which would cause pause in relying on such information. S.C. Code Ann. §33-8-300(c) (Law. Co-op. 1976). The evidence demonstrates that Simchon relied on the advice of Elliott, Davis & Company, LLP and a Honduran law firm in deciding to move its sewing operations to Honduras. Furthermore, after Simchon was informed that SouthTrust was terminating its line of credit, Simchon sought the advice of Debtor's counsel, Billy Garrett, a member of the South Carolina bar, and ultimately followed the attorney's suggestion to purchase inventory from Debtor. These reasons further support a finding that Defendants complied with the statutory standard for directors and officers pursuant to S.C. Code Ann. §§33-8-300 and 33-8-420.<sup>17</sup>

The Trustee also argues that because Simchon owned 100% of the stock in STKG and 99% of stock in STKH, any transaction between Debtor and those two companies would give rise to a conflict of interest by Simchon.<sup>18</sup> Conflicts of interest are governed by S.C. Code §33-8-310 which provides as follows:

(a) A conflict of interest transaction is a transaction with the corporation in which a director of the corporation has a direct or indirect interest. A conflict of interest transaction is not voidable by the corporation solely because of the director's interest in the transaction if any one of the following is true:

(1) the material facts of the transaction and the director's interest were disclosed or known to the board of directors or a committee of the board of directors, and the board of

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<sup>17</sup> The statutory standards for officers are similarly set forth in S.C. Code Ann. §33-8-420 (Law. Co-op. 1976).

<sup>18</sup> While not specifically pled in the Second Amended Complaint, the Trustee argued in his Motion for Summary Judgment and in his Proposed Order on the trial on the merits that the transfers to STKH contravened the conflict of interest provisions set forth in S.C. Code Ann. §33-8-310.

directors or a committee authorized, approved, or ratified the transaction;  
(2) the material facts of the transaction and the director's interest were disclosed or known to the shareholders entitled to vote and they authorized, approved, or ratified the transaction; or  
(3) the transactions is fair to the corporation.

S.C. Code Ann. §33-8-310 (Law. Co-op. 1976 & Supp. 1999). The Trustee claims that, as 100% owner of STKG's stock and 99% owner of STKH, Simchon had an indirect interest in the transactions. See S.C. Code Ann. §33-8-310(b) (Law. Co-op. 1976) ("For purposes of this section, a director of the corporation has an indirect interest in a transaction if (1) another entity in which he has a material financial interest or in which he is a general partner is a party to the transaction or (2) another entity of which he is a director, officer, or trustee is a party to the transaction and the transaction is or should be considered by the board of directors of the corporation."). In order to meet the requirements of subsection (a)(1), "a conflict of interest transaction is authorized, approved, or ratified if it receives the affirmative vote of a majority of the directors on the board of directors (or in the committee) who have no direct or indirect interest in the transaction." See S.C. Code Ann. §33-8-310(c) (Law. Co-op. 1976) ("[B]ut a transaction may not be authorized, approved, or ratified under this section by a single director.").

In this case, the minutes from the corporate meetings reflect that discussions were undertaken regarding the move off-shore of Debtor's sewing operations and the purchase of Debtor's inventory by Simchon. The minutes for the meeting as far back as May 16, 1996 include the following: "Discussed starting to do work offshore (807) approved research and waiting on approval." At the next meeting on April 7, 1997, such discussions were continued, and the minutes reflect the following: "Discussed (807) plan program approved lease/operation contract to be drawn and executed" and "Discussed (807) plan program moving all work

offshore as we are ready.” Furthermore, on June 10, 1998, a special meeting was called into session to discuss, among other issues, the purchase of inventory by Simchon. The minutes read as follows:

Discussions with reference to the SouthTrust Situation, seeking financing from other institutions. Sam to continue purchasing product to try to save business.  
Discussed the importance of shipping every customer possible to keep good relationship, this will keep dilution down and bring in maximum income.  
Upon motion duly made, seconded and carried Sam Simchon would seek funds personally and purchase product at fare market, and re-sell product to keep Southern Textile Knitters, Inc. from filing bankruptcy.

Thus, Debtor’s directors, consisting of Simchon, Oded Simchon, Rebecca Simchon, and Levy Simchon, discussed the plan to move Debtor’s sewing operations offshore and to have Simchon purchase Debtor’s product to later resell it. Furthermore, even if the meeting’s minutes do not expressly reflect any discussions about the incorporation of STKG or other subject transactions, the Court finds that it can be inferred from the evidence that the other directors ratified the transactions that took place.

Pursuant to §33-8-310(a), if the requirements of subsection (a)(1) have been met, then “the burden of proving unfairness of any transaction covered by this section is on the party claiming unfairness.” S.C. Code Ann. §33-8-310(a) (Law. Co-op. 1976). The Court finds that in this case, the Trustee has not met his burden to prove that the transactions are voidable. As such, the Court concludes that the Fifth Cause of Action against Simchon is dismissed.

**g. Sixth Cause of Action against Simchon--Piercing the Corporate Veil**

In the Sixth Cause of Action alleged in the Second Amended Complaint, the Trustee

asserts that Simchon, Oded Simchon, Rebecca Simchon, and Levy Simchon<sup>19</sup> should be held personally liable for all of Debtor's debts through the piercing of the corporate veil. Piercing of the corporate veil is "an equitable remedy whereby a court disregards 'the existence of the corporation to make the corporation's individual principals and their personal assets liable for the debtors of the corporation.'" 718 Arch Street Assoc. v. Blatstein (In re Blatstein), 192 F.3d 88, 100 (3d Cir. 1999) (quoting In re Schuster, 132 B.R. 604, 607 (Bankr. D. Minn. 1991)). After a business has been incorporated, individuals acting on behalf of the corporation are generally shielded from liability. See Official Comment to S.C. Code Ann. §33-2-104 (Law. Co-op. 1976). It is not until the corporate veil is pierced that an officer, shareholder, or director of the corporation may be held individually liable for the corporation's debts. In the landmark case on this issue, the Fourth Circuit stated that "[t]his power to pierce the corporate veil . . . is to be exercised 'reluctantly' and cautiously' and the burden of establishing a basis for the disregard of the corporate fiction rests on the party asserting such claim." DeWitt Truck Brokers v. W. Ray Fleming Fruit Co., 540 F.2d 681, 683 (4th Cir. 1976).

A court's decision whether to pierce the veil depends upon the facts of each case. *Id.* at 684. In order to pierce the corporate veil and hold the directors of the corporation liable, the movant, in this case the Trustee, has the burden of meeting a two-pronged test by a preponderance of the evidence. See McGuffin v. Barman (In re BHB Enterprises, LLC), C/A No. 97-01975-W; 97-80227-W (Bankr. D.S.C. 10/1/1998); see also Armstrong v. Pedie (In re Dakota Drilling), 135 B.R. 878, 884 (Bankr. D.N.D. 1991). The first prong of the test used to determine whether the corporate veil should be pierced involves the Court's consideration of

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<sup>19</sup> The only defendant remaining under the Sixth Cause of Action is Simchon. The other defendants were granted judgment on partial findings.

eight factors:

1. Inadequate capitalization of a corporation;
2. Failure to observe corporate formalities;
3. Nonpayment of dividends;
4. Insolvency of the debtor corporation;
5. Corporate funds were siphoned off by controlling shareholders;
6. Non-functioning of other officers or directors;
7. Absence of corporate records; and
8. The corporation was merely a “facade” for the operation of the dominant stockholder or stockholders.

See id. at 686-87. “The conclusion to disregard the corporate entity may not, however, rest on a single factor, whether undercapitalization, disregard of corporation’s formalities, or what-not, but must involve a number of such factors . . . .” Id. at 687.

As to the first factor, the Trustee argues that the corporation is currently in the midst of a bankruptcy proceeding as evidence of gross undercapitalization. “Undercapitalization” means that “there is insufficient unencumbered capital to reasonably meet a corporation’s predictable and prospective liabilities in the event they were to arise.” Criswell v. Criswell, 52 B.R. 184, 195 (Bankr. E.D. Va. 1985). The court in DeWitt stated that “‘the obligation to provide adequate capital begins with incorporation and is a continuing obligation thereafter . . . during the corporation’s operations.’” DeWitt, 54 F.2d at 6896 (quoting Dix, Adequate Risk Capital, 52 NW. U.L. Rev. 478, 494 (1958)); see also Second Serv. System, Inc. v. St. Joseph Bank & Trust Co., 855 F.2d 406, 416 (7th Cir. 1988) (“[U]ndercapitalization, when considered at all, is evaluated with emphasis on the time of incorporation rather than thereafter.”). In this case,



Debtor began its business in October of 1988 and was quite successful until the events arising ten years later in 1998. Furthermore, the corporation was adequately capitalized throughout the vast majority of its operation, until downturn in business and the termination of a line of credit with SouthTrust led to financial difficulties.

The evidence presented at trial further demonstrates that corporate formalities were followed by Debtor. In fact, minutes of the meetings of the officers and directors were kept, and extensive financial records were maintained including annual unqualified audited financial statements. Debtor underwent audits by Elliot Davis & Company, LLC for the years ending 1995, 1996, and 1997 which resulted in unqualified opinions showing substantial revenues and net worth for those periods. The Court finds that the documents presented at trial evidence that Debtor was a corporation that regularly held shareholder and director meetings, regularly elected officers, and kept adequate business records.

The Trustee also alleges that during the final year of Debtor's existence, Debtor paid no dividends. The Court notes that, as a Subchapter S corporation, Debtor made distributions rather than paid dividends. Such distributions were made throughout Debtor's existence with the exception of the last year of operation, when Debtor suffered major financial problems. The Trustee has offered no evidence as to non-payment of distributions for the previous nine years and as such has failed to offer sufficient evidence that non-payment of dividends was characteristic of Debtor's corporation. Rather, the evidence indicates that tax distributions were made to the shareholders during the years of profitable operations.

The next factor to be considered is the insolvency of Debtor. As to Debtor's insolvency, the evidence establishes solvency until at least July 31, 1998, and this corporation was quite successful for the majority of its operations. Courts have also pointed out that some of the

factors that are considered in determining whether to pierce the corporate veil (i.e. undercapitalization, non-payment of dividends, and insolvency of the debtor) do not apply when the corporation in question is in bankruptcy. Ansel Properties, Inc. v. Nutri/System (In re Nutri/System), 178 B.R. 645, 654 (E.D. Pa. 1995). No evidence was presented by the Trustee to support the allegation that improper siphoning of corporate funds had taken place. Therefore, the Court finds that the first prong of the DeWitt test has not been satisfied.

The test for piercing the corporate veil is a two-part test. The second part of the test involves a determination of whether “injustice or fundamental unfairness” are present in the facts of the case. An analysis of the second prong is not necessary because, as indicated above, the Court finds that the first prong was not met; therefore, the Court finds that the Trustee has not met its burden of proof on the Sixth Cause of Action against Simchon; therefore, the cause of action is dismissed.

**h. Seventh Cause of Action against Defendants--Aiding and Abetting**

The Trustee has made claims against STKH and STKG for aiding and abetting Simchon’s alleged breach of fiduciary duty. In Future Group, II v. NationsBank, 478 S.E.2d 45 (S.C. 1996), the South Carolina Supreme Court stated that a cause of action for aiding and abetting a breach of fiduciary duty may be recognized “where the plaintiff proves (1) a breach of fiduciary duty owed to plaintiff (2) the defendant’s knowing participation in the breach, and (3) damages.” Id. at 50 (citing Holmes v. Young, 885 P.2d 305 (Colo. 1988)). The court continued by stating that “[t]he gravamen of the claim is the Defendant’s knowing participation in the fiduciary breach.” Id. As this Court has found that the actions of Simchon were in the best interests of Debtor, the evidence fails to show a breach of fiduciary duty. Therefore, the Seventh Cause of Action against Defendants is dismissed.

**i. Eighth Cause of Action against Simchon and STKH--Conversion**

The Trustee's Eighth Cause of Action asserts a cause of action in conversion against Defendants on the grounds that they took possession and control of Debtor's inventory, equipment, cash, and production and sales operations to the exclusion of the interests of Plaintiff.<sup>20</sup> Under South Carolina law, conversion is defined as "an unauthorized assumption and exercise of the right of ownership over goods or personal chattels belonging to another or the alteration of their condition or the exclusion of an owner's rights." Dawkins v. National Liberty Life Ins. Co., 263 F. Supp. 119, 121 (D.S.C. 1967); see also Castell v. Stephenson Finance Co., 135 S.E.2d 311, 313 (S.C. 1964) (citing Young v. Corbitt Motor Truck Co., 146 S.E. 534) ("Conversion is a tortious act and 'may arise whether by a wrongful taking of the chattel or by some other illegal assumption of ownership, by illegally using or misusing it, or by wrongful detention.'"). To establish the tort of conversion, the plaintiff has the burden to prove either title to the personal property or right to possession of the property at the time demand for turnover was made. McGuffin v. Barman (In re BHB Enterprises, LLC), C/A No. 97-01975-W; Adv. Pro. 97-80227-W (Bankr. D.S.C. 10/1/1998); Causey v. Blanton, 314 S.E.2d 346 (S.C. Ct. App. 1984). The wrongful detention of another's personal property may also give rise to an action for conversion. In such cases, conversion occurs when, without justification or excuse, one refuses to surrender the possession of goods after demand for possession by the one entitled thereto, even if the retention is under a mistake in view of law that one has a right to detain the property. Oxford Finance co. v. Burgess, 402 S.E.2d 480 (S.C. 1991).

As it relates to the transfer of operating funds to STKH and of inventory to both STKH

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<sup>20</sup> Summary judgment was granted in favor of STKG as it relates to the Eighth Cause of Action.

and Simchon, the Trustee has failed to meet his burden of proof and the Court finds that neither Simchon nor STKH have exercised rights of ownership to the exclusion and detriment of Plaintiff's interest. The Court finds that the transfers of operating funds to STKH and of inventory to both STKH and Simchon cannot be avoided by the Trustee pursuant to §§547(b) or 548; therefore, the Trustee cannot claim any ownership right as to those assets.

However, the Court finds that STKH and Simchon, the person in control of the Honduran corporation, did convert the equipment at issue by failing to return it upon demand while not making the \$3,000 monthly lease payment. As previously held in this Order, the equipment was transferred to the Honduran corporation to be used in sewing operations. Title to the equipment was never transferred to STKH and remains property of the bankruptcy estate. Despite Plaintiff's request to have the equipment returned to the United States, STKH is still in possession of it. Furthermore, at Simchon's deposition, during a line of questioning regarding the whereabouts of the equipment and the possibility of the Trustee to go to Honduras to inspect it and to get it, Simchon discouraged the Trustee from going to STKH to examine and take possession of the equipment:

Question:	You said that Southern Textile Knitters of Honduras is willing to allow the trustee to get the equipment?
Answer:	The equipment belongs to STK, Inc. it doesn't belong to STK de Honduras.
Question:	So the trustee can go and get it.
Answer:	I am not objecting. I mean, whether he can get into the facility and retrieve it is another question, but that is not up to me.
Question:	Who would stop him?
Answer:	The guards at the gate.
Question:	There are guards at this industrial park?
Answer:	Probably about forty or fifty with AK-47s.

The actions of STKH and Simchon clearly constitute wrongful detention of property of the

estate, thus giving rise to a cause of action under conversion. In South Carolina, the law “has long embraced the rule that the measure of damages in an action for conversion is the value of the property with interest and that the jury may award the highest value up to the time of trial.” Causey v. Blanton, 314 S.E.2d 346 (S.C. Ct. App. 1984); see also In re Mosher, 420 F. Supp. 898, 904 (S.D. Tex. 1976) (noting that in an action for damages for conversion, plaintiff can recover “not only the fair market value of the converted chattel but also damages for the loss of use of the chattel between the date of conversion and judgment). In this case, the parties have failed to present any credible evidence regarding the value of the equipment at issue; therefore, the Court orders that the equipment be returned to the United States and given to the Trustee within the next 30 days. Furthermore, the Court finds that the loss of use of said equipment is best measured by the \$3,000 per month, which represents the lease payment the parties had agreed to.

### **CONCLUSION**

The Court is aware of the difficulties in proof that a Trustee faces in avoiding alleged transfers to insiders, directors of a corporation and other related entities. For that reason, the Trustee in this case was given great latitude in maintaining the various causes of actions asserted in the Complaint which included being allowed multiple amendments to his complaint and being given full consideration on many dispositive motions. Nevertheless, in order to sustain such serious allegations at trial; the Trustee must present sufficient and convincing proof -by preponderance of the evidence- in most of the causes of actions. In this matter, he failed to meet that standard as to many of the claims asserted.

Upon review of the evidence, pleadings and arguments of counsel, the Court finds that Judgment is granted in favor of Defendants on the following remaining causes of action: (a) First

Cause of Action as it relates to STKG; (b) Second Cause of action- preferential transfers pursuant to §547; (c) Third Cause of Action- fraudulent transfers pursuant to §548; (d) Fifth Cause of Action- breach of fiduciary duty as it relates to Simchon; (e) Sixth Cause of Action- piercing the corporate veil as it relates to Simchon; (f) Seventh Cause of Action- aiding and abetting; (g) Eighth Cause of action- conversion as it relates to the transfer of operating funds to STKH and of inventory to both STKH and Simchon; and (h) Ninth Cause of Action- fraudulent transfers pursuant to South Carolina Code §27-23-10.

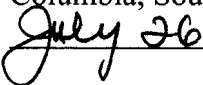
The Court finds in favor of the Trustee as it relates to the First Cause of Action (Turnover); the Eighth Cause of Action (Conversion) as it relates to the equipment transferred to STKH; and the Thirteenth Cause of Action as it relates to STKH (Rent Due). It is therefore,

**ORDERED** that STKH and Simchon turn over the equipment to the Trustee within 30 days.

**IT IS FURTHER ORDERED** that STKH and Simchon pay to the estate the sum of \$114,000.00, the rent due under the lease of Debtor's equipment from May 1, 1997 to present, and continuing until the equipment is turned over.

**AND IT IS SO ORDERED.**

  
UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina  
 July 26, 2000